

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

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**PJM Interconnection, LLC**

**Docket No. ER04-539-000**

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**REQUEST FOR REHEARING AND CLARIFICATION  
OF THE  
ILLINOIS COMMERCE COMMISSION**

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.713, the Illinois Commerce Commission ("ICC") hereby respectfully submits its Request for Rehearing and Clarification of the Commission's Order on Market Mitigation Mechanisms, *PJM Interconnection, LLC*, 106 FERC ¶ 61,277 (2004), issued March 24, 2004, in the above-captioned proceeding.

**I. BACKGROUND**

On December 31, 2003, in Docket No. ER04-521-000, PJM Interconnection, L.L.C. ("PJM") noted concerns by the PJM market monitor regarding the possibility of market power and the need for mitigation of that market power in the Northern Illinois Control Area ("NICA") upon Commonwealth Edison Company's ("ComEd") integration into PJM.

On February 5, 2004, PJM filed provisions in Docket No. ER04-539-000 setting forth market power mitigation measures for the NICA markets and proposed that those market power mitigation measures become effective when ComEd is integrated into the

PJM markets. On February 25, 2004, the ICC filed a notice of intervention. On March 24, 2004, the Commission issued an Order rejecting PJM's proposed market power mitigation measures.<sup>1</sup> This filing requests rehearing and clarification on six Commission errors contained in that March 24<sup>th</sup> Order.

## **II. ICC's SPECIFICATION OF COMMISSION ERRORS**

1. The Commission erred in rejecting PJM's proposal to apply the existing market power mitigation provisions in Section 6.4 of PJM's tariff to the unique circumstances of the NICA energy market by assessing when the 500 MW pathway from PJM to NICA is constrained.
2. The Commission erred in rejecting PJM's proposal for market power mitigation for NICA under "extreme conditions" in the PJM energy market.
3. The Commission erred in its evaluation of energy import capability into NICA.
4. The Commission erred in rejecting PJM's proposed capacity market power mitigation measures in their entirety.
5. The Commission erred in stating that the joint and common market "will not be able to begin operating" until "2005 at the earliest."
6. The Commission erred in stating that ComEd owns generation resources and in expecting wholesale power contracts to reduce or eliminate sellers' incentives to exercise market power in NICA.

## **III. ICC REQUEST FOR REHEARING AND CLARIFICATION**

- A. The Commission erred in rejecting PJM's proposal to apply the existing market power mitigation provisions in Section 6.4 of PJM's tariff to the unique circumstances of the NICA energy market by assessing when the 500MW pathway from PJM to NICA is constrained.**

In its December 31, 2003 filing in Docket ER04-521-000, PJM stated,

Regarding pathway constraints from PJM to the Northern Illinois Control Area, PJM already has authority under section 6.4 of its market rules to cap at cost the offers of generating units that must run for reliability or otherwise enter into agreements with generators to mitigate resulting market power. See Operating Agreement Schedule 1 ¶6.4. These

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<sup>1</sup> *PJM Interconnection, LLC*, 106 FERC ¶ 61, 277 (2004) (*hereinafter*, "March 24 Order").

provisions apply in the circumstance described by the MMU where energy cannot be delivered from the rest of PJM to the Northern Illinois Control Area to serve loads in that area. PJM intends to invoke this mitigation authority as needed in the Northern Illinois Control Area when transmission is constrained from PJM to the Northern Illinois Control Area. In effect, the Northern Illinois Control Area is a PJM load pocket in these limited hours, subject to mitigation under section 6.4. However, **the MMU also will monitor whether the availability of energy from other control areas adequately disciplines market power of must-run generators in the Northern Illinois Control Area.** See NICA Competitiveness Report at 4-5. **PJM will not invoke section 6.4 if there are adequate external sources to mitigate market power.**<sup>2</sup>

Consequently, in Docket ER04-521-000, PJM proposed no new additional market power measures for NICA, other than those market power measures already in PJM's tariff and applicable to PJM's previous territory. However, the excerpt from PJM's December 31 filing in Docket ER04-521-000 quoted above constituted a statement of intent by PJM to apply its existing Section 6.4 market power measures to the NICA market in a particular circumstance, *i.e.*, "when transmission is constrained from PJM to the Northern Illinois Control Area." With that statement of intent, PJM recognized the unique characteristics and market power implications of integrating the NICA market into PJM via the proposed 500 MW pathway through American Electric Power Company's ("AEP") service territory.

In its Order issued on March 18, 2004, the Commission addressed PJM's December 31, 2003 filing in Docket ER04-521-000.<sup>3</sup> In that Order, the Commission stated that the NICA market power mitigation proposal submitted by PJM in Docket ER04-521-000 would be addressed in the Commission's Order addressing PJM's

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<sup>2</sup> PJM December 31 Filing at 40-41(emphasis added).

<sup>3</sup> *PJM Interconnection, LLC*, 106 FERC ¶ 61, 253 (2004). (*hereinafter*, "March 18 Order").

additional NICA market power mitigation measures proposed by PJM on February 5, 2004, in Docket ER04-539.<sup>4</sup>

In the March 24 Order, the Commission addressed the market power mitigation proposal submitted by PJM on December 31, 2003 in Docket ER04-521-000. Therein, the Commission stated,

The Commission finds it unreasonable for PJM to base its mitigation trigger solely on whether the 500 MW pathway to PJM is congested, particularly when there may be an ample supply of capacity that could be imported into NICA and/or a significant percentage of load is protected from the exercise of market power through ownership or contracts with generators.<sup>5</sup>

The ICC believes that the Commission erred in rejecting PJM's proposal to apply the market power mitigation provisions of Section 6.4 to the unique circumstances of NICA's integration into PJM by assessing congestion on the 500 MW pathway from PJM to NICA. The Commission's statement that PJM's market power mitigation trigger is based "solely on whether the 500 MW pathway to PJM is congested," conflicts with the language of PJM's December 31 filing. Indeed, the applicable congestion under these circumstances is in the direction from PJM to NICA, not ""to PJM"" as stated by the Commission. Furthermore, with respect to imports, PJM clearly stated, "the MMU also will monitor whether the availability of energy from other control areas adequately disciplines market power of must-run generators in the Northern Illinois Control Area."<sup>6</sup>

Given these PJM statements, the Commission's rejection of PJM's proposal to apply the provisions of Section 6.4 of its existing tariff to the unique circumstances of the NICA energy market (by PJM assessing when the 500 MW pathway from PJM to NICA

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<sup>4</sup> March 18 Order at P56.

<sup>5</sup> March 24 Order at P31.

<sup>6</sup> PJM December 31 Filing at 41.

is constrained) is based on a false premise and a misunderstanding. PJM did not state an intent to apply the market power mitigation provisions of Section 6.4 based “solely on whether the 500 MW pathway to PJM is congested” as stated by the Commission. Rather, PJM explicitly stated that it would “monitor whether the availability of energy from other control areas adequately disciplines market power.” Furthermore, the direction of the congestion at issue under these circumstances is that from PJM to NICA, as stated by PJM—not “to PJM” as stated by the Commission.

The ICC agrees that PJM should be more objective in the way that it takes into account energy imports into NICA when mitigating market power under the regular provisions of Section 6.4 of its tariff. However, the Commission’s decision to reject PJM’s pathway market power mitigation proposal in its entirety is unreasonable.

The ICC, therefore, requests rehearing of the Commission’s rejection of PJM’s December 31 statement of intent to apply the regular provisions of Section 6.4 of PJM’s tariff to the unique circumstances of the NICA market by taking into account constraints on the 500 MW pathway as well as imports into NICA. However, if the Commission is concerned that PJM’s proposal allows for too much subjectivity in assessing imports, the Commission should impose on PJM a requirement to more objectively take into account energy imports into NICA when deciding to impose the mitigation provisions of Section 6.4. The nature of the plan to integrate the NICA market into PJM through a limited 500 MW pathway requires serious attention to market power and targeted applications of market power mitigation when necessary. The Commission erred in rejecting PJM’s proposal to apply its existing market power mitigation measures to the unique characteristics of the NICA market and the 500 MW pathway.

**B. The Commission erred in rejecting PJM’s proposal for market power mitigation for NICA under “extreme conditions” in the PJM energy market.**

In its February 5, 2004 filing, PJM proposed to add a new provision to the market power mitigation provisions of Section 6.4 of its tariff to address the opportunities for the exercise of market power in NICA when “extreme conditions” exist in the regular PJM control area, but not in NICA. PJM proposed to declare a “NICA market power event” when defined extreme conditions develop in the PJM market. Specifically, PJM proposed adding the following paragraph to its tariff:

During the ComEd Integration Phase, the price for energy offered by any resource in the Northern Illinois Control Area shall be capped at the level specified in Section 6.4.2(ii) for the duration of any NICA Market Power Event declared by the Market Monitoring Unit. The Market Monitoring Unit shall declare a NICA Market Power Event solely in the event that the Market Monitoring Unit determines that there are extreme market conditions in the PJM Control Area but not in the Northern Illinois Control Area. For purposes of this subsection, extreme market conditions in the PJM Control Area shall exist when the average hourly LMP in such control area exceeds \$500 per MWh, and extreme conditions in the Northern Illinois Control Area shall exist when the sum of the forecasted daily demand plus real-time net exports in such control area is greater than the daily total control area supply capability minus 2,000 megawatts. For these purposes, total control area supply capability shall be defined as those resources not on planned, maintenance or forced outage for the day such calculation is performed.<sup>7</sup>

In its March 24 Order the Commission addressed this PJM proposal stating,

we will reject PJM's seller-specific bid cap proposal for extreme conditions without prejudice to a future proposal that either: (1) provides adequate justification for the triggering mechanism proposed in this docket, or (2) proposes a different triggering mechanism for the bid caps and provides an adequate justification for that mechanism.<sup>8</sup>

As with the Commission’s rejection of PJM’s proposed application of its existing market power mitigation measures to the unique circumstances of the 500 MW pathway

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<sup>7</sup> February 5 Filing, Proposed 1st Rev Original Sheet No. 402.

<sup>8</sup> March 24 Order at P32.

serving NICA (discussed in Section A above), FERC rejected PJM's proposed market power mitigation for extreme conditions largely on the argument that PJM failed to adequately evaluate the effect that imports into NICA may have on the ability of generators within NICA to exercise market power. The ICC will address the import issue in Section C below.

The ICC takes no issue with the Commission's decision to offer PJM an option to provide a more detailed analysis of how imports into the NICA market may affect the need for market power mitigation measures within NICA and the types of market power mitigation measures that may be appropriate within NICA. The ICC strongly urges PJM to provide that analysis. However, rather than rejecting PJM's proposed extreme conditions market power mitigation proposal without prejudice to PJM's re-filing it with additional support, the Commission would have better served the public interest in Illinois if it had accepted PJM's extreme conditions market power mitigation measures, subject to replacement should the additional analysis of imports to be provided by PJM show the initially proposed measures to be inappropriate or unneeded.

PJM's target date for integrating ComEd into the PJM market is May 1, 2004. In the past, the ICC has strongly supported ComEd's early integration into PJM, provided that all of the necessary conditions for that integration and market start-up have been satisfied.<sup>9</sup> One condition that is very important to the ICC is that the NICA market under PJM operation not be subject to market power. Given the unique and unprecedented nature of PJM's proposal to integrate ComEd into PJM's market via a 500 MW pathway, there is a need to be particularly cautious regarding the exercise of market power in

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<sup>9</sup> See, Comments of the Illinois Commerce Commission submitted in Docket ER04-521-000 on February 19, 2004.

NICA. Indeed, PJM's market monitor has identified numerous opportunities for the exercise of market power in the NICA.<sup>10</sup> These warnings, when paired with the fact that there have been no credible analyses submitted showing that imports will be adequate to prevent the exercise of market power, make the Commission's decision to reject PJM's proposed energy market mitigation measures based solely on the possibility of imports disciplining the market and dampening opportunities for the exercise of market power within NICA a very risky gambit. An out-of-control power market in the third largest city in the United States during what could be a long, hot summer of 2004 is not a prospect to be treated lightly.

Accordingly, the ICC requests that the Commission rehear its decision to reject PJM's proposed extreme conditions market power mitigation measures. The ICC would not take issue with a Commission Order imposing PJM's extreme conditions market power mitigation proposal subject to repeal upon receipt of further evidence from PJM showing that these market power mitigation measures are not needed or that alternative measures would be more appropriate. However, the ICC does take issue with the Commission's rejection of PJM's proposal without replacing it with something else. Particularly given the unique circumstances of ComEd's integration into PJM, such action is not reasonable. Adequate market power measures need to be in place before PJM initiates market operations for NICA. The Commission has not made a determination that adequate market power mitigation measures are in place for NICA. Rather, the Commission simply rejected the market power mitigation measures proposed by PJM. The ICC urges the Commission to rehear this issue and accept the proposed NICA market power mitigation measures for extreme conditions in PJM, subject to

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<sup>10</sup> PJM December 31 Filing at 41.



repeal or amendment upon a showing that the measures are not needed or that alternative measures would be more appropriate.

**C. The Commission erred in its evaluation of energy import capability into NICA.**

As explained above, the Commission's rejection of both of PJM's unique energy market power mitigation measures for NICA (the pathway proposal and the extreme conditions proposal) rests on the Commission's assessment of import data provided by PJM. For example, the Commission's March 24 Order states:

As many intervening parties argue, PJM, in employing such a trigger, chose not to consider the impact that imports from neighboring regions could have in mitigating market power in NICA. Based on the record in this case, we are not persuaded by PJM's reasoning. . . . PJM's rationale fails to adequately consider the effects on competition in NICA of the much larger transmission capabilities between NICA and its immediate neighbors, or between NICA and AEP, which according to Edison Mission's witness, amounts to 12,500 MW and 5,375 MW respectively.<sup>11</sup>

The Commission's statement that PJM "chose not to consider the impact" that energy imports into NICA could have on the NICA market is simply not accurate. In his Declaration submitted on March 12, 2004, in Docket No. ER04-539-000 ("March 12 Declaration"), PJM's market monitor, Joseph E. Bowring, described his analysis of imports into NICA as follows:

In order to test the expected role of imports more directly, the MMU performed a sensitivity analysis using GE MAPS. In this sensitivity, a 3,000 MW block of mid-merit generation was eliminated in the NICA and then the entire Eastern Interconnection was economically redispatched, in order to determine how the generation would be replaced. This is a direct test of the extent to which there are competitive external resources that can be imported to compete with base load and mid-merit generation resources within NICA.<sup>12</sup>

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<sup>11</sup> March 24 Order at P28.

<sup>12</sup> Declaration of Joseph E. Bowring, Docket No. ER04-539-000, filed on March 12, 2004, page 4 at paragraph 14.

Mr. Bowring goes on in his Declaration to describe the results of his examination of the effect of imports into NICA on market performance within NICA.<sup>13</sup>

Furthermore, the Commission's statement in Paragraph 28 of the March 24 Order that PJM "chose not to consider the impact that imports from neighboring regions could have in mitigating market power in NICA" is directly contradicted by the Commission's statement in Paragraph 29 of the March 24 Order that states,

we are not persuaded by PJM's arguments in its answer to protests that imports provide inadequate competitive discipline. PJM's argument is not that imports are unavailable, but rather, that they are more costly than energy produced by mid-merit resources within NICA.<sup>14</sup>

These two Commission statements are contradictory and clearly show that PJM did, indeed, take energy imports into account in its NICA market power analysis. While the Commission may be unsatisfied with the type or extent of import analyses conducted by PJM, the Commission's statement that PJM "chose not to consider" the impact of imports is simply not true.

Furthermore, Mr. Bowring's March 12 Declaration contains a response to the specific import capability data offered by Edison Mission Energy's ("EME" or "Edison Mission") witness, Dr. Shanker. Specifically, Mr. Bowring stated,

Dr. Shanker misstates the level of import and export capability into and out of the NICA. What is relevant for competition is the maximum simultaneous import capability of the control area and not the separately calculated interface Total Transmission Capability (TTC) numbers. TTC levels are calculated under the assumption that all interchange for the region occurs on the single interface analyzed. Clearly, the relevant number for competition is the simultaneous import capability and not the sum of individual interface TTCs. The maximum simultaneous import capability is between 3,400 MW and 4,900 MW.<sup>15</sup>

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<sup>13</sup> Declaration of Joseph E. Bowring, Docket No. ER04-539-000, filed on March 12, 2004, page 5 at paragraph 15.

<sup>14</sup> March 24 Order at P29.

<sup>15</sup> Declaration of Joseph E. Bowring, Docket No. ER04-539-000, filed on March 12, 2004, page 8,

The ICC's examination of the evidence provided by both Dr. Shanker and Mr. Bowring shows that the question of import capability into NICA is, at best, a disputed issue of material fact. However, given that simultaneous import capability is a much better and more accurate measure of the competitive threat from imports than the sum of individual interface TTCs, it appears that Mr. Bowring has the stronger argument. For these reasons, the Commission erred when it rejected PJM's proposed tariff revisions/applications and decided, based on inaccurate data, that imports into NICA will provide a sufficient competitive threat to NICA generators.

Accordingly, the ICC requests rehearing of the Commission's statement that PJM "chose not to consider the impact that imports from neighboring regions could have in mitigating market power in NICA." The ICC also requests that the Commission reverse its reliance on the import data provided by EME's witness, Dr. Shanker. The ICC would not take issue if the Commission had accepted PJM's proposed NICA energy market power mitigation measures subject to a condition requiring PJM to provide additional analysis about how imports into NICA will affect the nature of energy market competition within NICA. However, the Commission's mischaracterization of the data on imports that was provided by PJM, in addition to the Commission's reliance on EME's incomplete import capability data,<sup>16</sup> led the Commission to an inappropriate rejection of all of PJM's proposed market power mitigation measures that were designed to address the unique aspects of integrating ComEd into the PJM market via a 500 MW pathway through AEP. That result is unreasonable. The ICC, therefore, urges the

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paragraph 23.

<sup>16</sup> See *AEP Power Marketing, Inc. et al.* 107 FERC ¶ 61,018 (2004) at P. 66 (requiring simultaneous transmission import capability be taken into account when conducting pivotal supplier and market share screens in assessing generation market power).

Commission to rehear this issue and reverse its reliance on inaccurate import data as described above.

**D. The Commission erred in rejecting PJM's proposed capacity market power mitigation measures in their entirety.**

In its February 5 filing, PJM stated,

The PJM market monitor has concluded that "when the capacity market begins, as the result of the structural conditions in the NICA market, that the capacity market in NICA will face market power issues. [footnote omitted] Specifically, the PJM market monitor analysis indicates that one generator currently owns or controls more than fifty percent of total capacity in NICA [footnote omitted] and that at least two generation owners will be pivotal in the capacity market. [footnote omitted] Based on this analysis, the PJM market monitor has determined that "the structure of capacity ownership and the nature of the capacity markets will result in the ability of some generators to exercise market power in the NICA capacity market." [footnote omitted] Thus, the PJM market monitor recommends that market mitigation measures be implemented by the currently anticipated opening of the NICA capacity markets on June 4, 2004.<sup>17</sup>

The specific NICA capacity market mitigation measure proposed by PJM is that,

capacity will be offer capped at \$30 per MW-day, plus any additional amounts that are shown to the satisfaction of the PJM market monitor to compensate the seller of capacity for its opportunity cost. In the event there are scarcity conditions, this cap will be raised to \$160 per MW-day. The PJM market monitor also will screen capacity offers in the NICA capacity credit markets to ensure that the NICA capacity markets are competitive.<sup>18</sup>

The Commission addressed this NICA capacity market mitigation measure in its March 24 Order stating,

The Commission does not believe that PJM has proposed rules that are sufficiently clear with regard to the capacity offer cap, specifically as to any additional amounts added to the initial \$30 per megawatt day cap.<sup>19</sup>

and,

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<sup>17</sup> February 5 filing at 7.

<sup>18</sup> February 5 filing at 2.

<sup>19</sup> March 24 Order at P35.

We are not persuaded that PJM's proposed bid cap of \$160 per megawatt day during scarcity periods is reasonable.<sup>20</sup>

The Commission concluded,

we will reject PJM's proposal for mitigation of the capacity markets, without prejudice to a future filing that provides adequate support, including an analysis of the effects on competition of all potential sources of capacity.<sup>21</sup>

Consequently, the Commission rejected PJM's proposal for capacity market power mitigation during "normal" periods on the Commission's finding that the prices proposed to be allowed by PJM to capacity sellers above \$30 to account for opportunity costs or any other actual annual avoidable incremental costs were not sufficiently clear and that PJM had reserved too much subjectivity for itself in determining the level above \$30.<sup>22</sup> The Commission rejected PJM's proposal for capacity market power mitigation during "scarcity" periods on the Commission's finding that "the \$160 cap is too low if it is to be applied only during periods of scarcity."<sup>23</sup>

The ICC requests rehearing of the Commission's decision to completely reject PJM's proposed capacity market mitigation measures without replacing PJM's proposal with an alternative or specifically directing PJM to replace its proposal with an alternative. Unless alternative capacity market power mitigation measures are put in place to replace the capacity market power mitigation measures proposed by PJM and rejected by the Commission in the March 24 Order, the NICA market operated by PJM will potentially start up on May 1, 2004 without any capacity market power mitigation

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<sup>20</sup> March 24 Order at P37.

<sup>21</sup> March 24 Order at P37.

<sup>22</sup> March 24 Order at P35.

<sup>23</sup> March 24 Order at P37

measures in place. That result is entirely unacceptable to the ICC, especially given the PJM market monitor's un-hedged warning that

when the capacity market begins, as the result of the structural conditions in the NICA market, the capacity market in NICA will face market power issues.<sup>24</sup>

Due to PJM's proposed capacity adequacy construct, market power in NICA's capacity market will actually be increased by the integration of ComEd into PJM. Under these circumstances, the Commission's rejection of all NICA capacity market power mitigation measures is, most certainly, unreasonable. The ICC, therefore, requests rehearing and urges the Commission to either reinstate the rejected capacity market power mitigation measures or direct PJM to submit replacement capacity market power mitigation measures to become effective prior to ComEd's integration into the PJM market.

Finally, the March 24 Order incorrectly states that the opening of NICA's capacity market is currently scheduled for June 4, 2004.<sup>25</sup> PJM's February 5 filing also incorrectly states that the currently anticipated opening of the NICA capacity markets is June 4, 2004.<sup>26</sup> Both of these dates conflict with footnote 20 of PJM's February 5 filing, where PJM refers to the study titled "PJM MMU Proposed Market Power Mitigation Protocol for NICA Capacity Markets" which states, "These measures should be implemented at the currently anticipated opening of the capacity markets on June 1, 2004."<sup>27</sup>

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<sup>24</sup> PJM MMU Proposed Market Power Mitigation Protocol for NICA Capacity Markets, at p. 1 (Dec. 8, 2003) ("NICA Capacity Market Report").

<sup>25</sup> March 24 Order at P12.

<sup>26</sup> PJM February 5 filing at 7-8.

<sup>27</sup> "PJM MMU Proposed Market Power Mitigation Protocol for NICA Capacity Markets", December 8, 2003, page 1, item 2a.

The ICC urges the Commission to clarify this inadvertent error in its March 24 Order—the opening date for NICA’s capacity market is currently scheduled for June 1, rather than June 4.

**E. The Commission erred in stating that the joint and common market “will not be able to begin operating” until “2005 at the earliest.”**

In the March 24 Order, the Commission referred back to its July 31, 2002 Order in which the Commission accepted the RTO choices of the former Alliance Companies conditioned on satisfactory completion of nine conditions, one of which is the formation of a common market.<sup>28</sup> The Commission’s March 24 Order stated,

In the July 31 Order, the Commission also noted concerns that the elongated and irregular seam that would result from splitting the former Alliance group between PJM and the Midwest Independent Transmission System Operator (MISO) might cause that choice not to be just and reasonable. The Commission found, however, that the New PJM Companies' choices could be rendered just and reasonable through certain conditions. [footnote 4] The Commission therefore ordered PJM and MISO to form a "functional common market" across the two organizations by October 1, 2004.<sup>29</sup>

In footnote 4 of the March 24 Order, the Commission stated, “PJM and MISO will not be able to begin operating their joint and common market until 2005 at the earliest.”

The ICC requests clarification of this statement in footnote 4 of the March 24 Order. The Commission cites no source to support its statement that PJM and MISO will not be able to begin operating their joint and common market until 2005 at the earliest. It is the ICC’s position that PJM and MISO would be able to begin implementing the common market starting on the date that MISO initiates market operations (currently expected for December 1, 2004) regardless of whether or not AEP is integrated into PJM’s market by that date.

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<sup>28</sup> *Alliance Companies, et al.*, 100 FERC ¶ 61,137 (2002) (*hereinafter*, “July 31 Order”).

<sup>29</sup> March 24 Order at P3.

The ICC urges the Commission: (1) to hold fast on its common market condition; (2) not to concede that PJM and MISO are “unable” to implement elements of the common market upon MISO’s market start-up on December 1, 2004; (3) to make clear that satisfaction of the common market condition imposed in the July 31 Order remains outstanding; and (3) to make clear that timely and full implementation of the common market (i.e., no later than nine months from the date MISO begins market operations) remains necessary for ComEd’s integration into PJM to be just and reasonable.<sup>30</sup>

As specifically applicable to the market power mitigation issues in the instant docket, it is the ICC’s position that a joint and common market between MISO and PJM will enhance the structural conditions for competition in the combined footprints of MISO and PJM and greatly reduce the need to impose the market power mitigation measures proposed by PJM in its February 5 filing. Early implementation of the PJM/MISO common market would greatly improve the structural conditions of markets in NICA by facilitating competitive imports into NICA and elsewhere throughout the combined PJM/MISO footprint.

For these reasons, the ICC recommends that the Commission withdraw its unsubstantiated statement in the March 24 Order that it will not be possible to implement the common market “until 2005 at the earliest.” The ICC urges the Commission to direct PJM and MISO to initiate joint and common market elements as soon as MISO’s day-ahead and real-time energy markets start up, which is currently scheduled for December 1, 2004.

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<sup>30</sup> In its July 31 Order, the Commission stated that nine months from the date MISO begins its LMP-based markets “is ample time to allow both organizations to overlay the market across the entire region.” 100 FERC ¶ 61,137 at P40.



**F. The Commission erred in stating that ComEd owns generation resources and in expecting wholesale power contracts to reduce or eliminate sellers' incentives to exercise market power in NICA.**

In the March 24 Order, the Commission discussed the effects that power contracts might have on incentives for generation sellers to exercise market power in the NICA energy spot market.<sup>31</sup> Specifically, the Commission found PJM's analysis of the "effects of contracts on competition in the spot market to be incomplete."<sup>32</sup>

The Commission's March 24 Order states, "it is not clear how PJM took into account the fact that ComEd, as a buyer, owns generation resources."<sup>33</sup> This Commission statement is not accurate and, unfortunately, reveals the Commission's incomplete comprehension of the particularities of the market situation in northern Illinois, as ComEd no longer owns generation resources. Indeed, the generation resources that were previously owned by ComEd were sold to affiliates and non-affiliates.<sup>34</sup> If the Commission means to indicate that ComEd has acquired the rights, through power purchase contracts, to control generation resources—that assertion would also be incorrect. ComEd has entered into arrangements with an Exelon affiliate (Exelon Generation Company, L.L.C.) to act as ComEd's sole power supplier. It is Exelon Generation Company that both owns generation resources and controls generation

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<sup>31</sup> March 24 Order at P30.

<sup>32</sup> March 24 Order at P30.

<sup>33</sup> March 24 Order at P30.

<sup>34</sup> Fossil - Commonwealth Edison sold its 1,108 MW coal-fired Kincaid station to an indirect subsidiary of Dominion Resources, Inc. *See Kincaid Generation, L.L.C.*, 78 FERC ¶62,060 (1997); Commonwealth Edison sold its 490 MW coal-fired State Line station to an indirect subsidiary of The Southern Company. *See State Line Energy, L.L.C.*, 78 FERC ¶62,037 (1997). Commonwealth Edison sold its remaining 9,772 MW of non-nuclear generation to Edison Mission Energy, Inc. (Mission Energy). *See Commonwealth Edison Company, et al.*, 89 FERC ¶62,105 (1999). *See also, Commonwealth Edison Company, et al.*, 91 FERC ¶61,036 (2000); *Commonwealth Edison Company*, 91 FERC ¶61,033 (2000); *Commonwealth Edison Company*, 93 FERC ¶61,040 (2000) and *Exelon Generation Company, L.L.C., et al.*, 93 FERC ¶61,140, (2000).

resources through contracts for purchased power that is then resold to ComEd so that ComEd can satisfy its retail sales obligations.

The Commission's apparent willingness to rely on extensive bilateral contracting for power to reduce the incentives of power sellers in NICA (such as Exelon Generation) to exercise market power in the energy spot markets is misplaced. The Commission states,

The incentive of generators to exercise market power in the spot market is reduced or eliminated to the extent that the generators are owned or contractually committed to buyers. The reason is that energy from such generators is produced and sold outside of the spot market. Generators' compensation for such energy does not depend on spot market prices, and thus, would not increase due to the exercise of market power in the spot market.<sup>35</sup>

This expectation by the Commission is not supported by the market conditions in NICA. As pointed out above, ComEd has entered into arrangements with Exelon Generation Company to act as ComEd's sole power supplier. To the extent that Exelon Generation Company expects that the ICC might establish ComEd's bundled retail rates at levels that would permit the pass-through of excessive costs arising from exercise of market power in the wholesale market, Exelon Generation Company would have an incentive to exercise market power in the energy spot market so as to leverage those higher "market" prices into contracts it enters into with its public utility affiliate, ComEd for subsequent pass-through into retail rates.

The ICC has significant reason to be concerned that this scenario will indeed play out in northern Illinois. First, each of the Exelon affiliates, including Exelon Generation Company, has been authorized by the Commission (on the basis of the now-superseded

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<sup>35</sup> March 24 Order at P30.

hub-and-spoke test) to sell wholesale power at market-based rates.<sup>36</sup> In addition, because the Commission has granted the Exelon affiliates a waiver of the Commission's otherwise applicable requirement that power purchase contracts with affiliates be filed for self-dealing review and prior approval by the Commission, wholesale contracts under which ComEd will purchase power from Exelon Generation Company will automatically be permitted by the Commission to go into effect without review.<sup>37</sup>

Furthermore, the ICC will be circumscribed by the federal filed rate doctrine in its ability to address Exelon Generation Company market power in the context of setting new ComEd bundled retail rates to be effective after January 1, 2007. The federal filed rate doctrine requires the ICC to permit retail rates to reflect the wholesale rates the Commission authorizes and may require the ICC to permit retail rates to reflect the wholesale rates that the Commission merely allows to go into effect without review.<sup>38</sup> While the ICC will have some authority to assess the prudence of ComEd's decisions to enter into wholesale power contracts,<sup>39</sup> the limited transmission import capability into ComEd's service territory (3,400 MW and 4,900 MW)<sup>40</sup> and the high concentration of generation ownership/control within ComEd's service territory<sup>41</sup> will significantly increase the difficulty of proof in such cases. Typically, proof that a utility acted imprudently in entering into a transaction takes the form of evidence of available, cheaper

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<sup>36</sup> *Exelon Generating Company L.L.C., et.al*, 93 FERC 61,140 (2000).

<sup>37</sup> *Exelon Generating Company L.L.C., et.al*, 93 FERC 61,140 (2000) at page 10-11 (citing *Illinova Power Marketing, Inc.* 88 FERC 61,189 (1999)).

<sup>38</sup> *Narragansett Electric Co. v. Burke*, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

<sup>39</sup> *See, Pike County Light & Power Co. v. Pennsylvania PUC*, 465 A.2d 735, 738 (1983) (establishing that the filed rate doctrine does not restrict the authority of State commissions to engage in prudence reviews).

<sup>40</sup> Declaration of Joseph E. Bowring, Docket No. ER04-539-000, filed on March 12, 2004, page 8, paragraph 23.

<sup>41</sup> February 5 filing at 7.

alternatives that the utility passed up to enter into the contract in question.<sup>42</sup> However, given the limited transmission import capability into ComEd's service territory, the high concentration of generation ownership/control within ComEd's service territory, and the compounding effect of ComEd's sole supplier arrangement with its affiliate Exelon Generation, generation supply alternatives for ComEd may be very limited. ComEd may be able to argue that no better alternatives existed than the chosen transactions, which will be transactions with ComEd's Exelon affiliate under the sole supplier arrangement that ComEd has with Exelon.

In previous decisions, the Commission recognized the difficulty of proving the imprudence of a utility entering into transactions to purchase power at a given price instead of seeking out available, alternative, more economical supplies of electricity. Specifically, in *Heartland Energy Services, Inc.*, the Commission addressed this issue while discussing a request for market-based rate authority and making the Commission's traditional inquiry into affiliate abuse in the context of its review of a market-based rate request. The Commission stated as follows:

It is very difficult to prove in a rate case that a public utility did not aggressively seek opportunities to purchase cheaper power for its ratepayers; therefore, it is unlikely that the Commission can rely solely on prudence inquiries in the rate case process to police this type of potential abuse.<sup>43</sup>

The ICC will likely be confronted with similar issues in the near future when making its prudence reviews of ComEd's power purchase decisions for the post-rate-

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<sup>42</sup> See e.g., *Pike County* at 271 (upholding the State commission's ruling that Pike's reliance on its parent as a source of power was 'an abuse of management discretion in consideration of available, alternative, more economical, supplies of electricity').

<sup>43</sup> *Heartland Energy Services, Inc.*, 68 FERC ¶ 61,223, at 62,062(1994). See also, *H.Q. Energy Services (U.S.) Inc.*, 79 FERC ¶61,152 (1997); *Progress Power Marketing, Inc.*, 76 FERC ¶61,155 at p. 61,919 (1996); *Northwest Power Marketing Company, L.L.C.*, 75 FERC ¶61,281, at p. 61,889 (1996).

freeze period. Accordingly, the strength of the ICC's regulatory authority at the retail level may be insufficient to prevent the power price effects resulting from the exercise of market power at the wholesale level from being passed-through into bundled retail rates. Unless the Commission effectively polices the exercise of market power in the wholesale markets, retail customers in the ComEd control area will have insufficient protection from Exelon market power and affiliate self-dealing.<sup>44</sup>

By relying on an expectation that bilateral contracting will reduce incentives for power sellers in NICA (such as Exelon Generation Company) to exercise wholesale market power, the Commission errs and fails to perform its statutory obligation to ensure just and reasonable rates. The ICC, therefore, requests rehearing of the Commission's position that wholesale contracting will reduce or eliminate the incentives of generators in NICA to exercise market power.

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<sup>44</sup> See, *Entergy Services, Inc., et al.*, 103 FERC ¶ 61,256 (2003) and *Southern Power Company* 104 FERC ¶ 61, 041 (2003).

#### IV. CONCLUSION

WHEREFORE, as explained herein, the Illinois Commerce Commission respectfully requests that the Commission grant rehearing and clarification of its March 24 Order.

Respectfully submitted,

*/s/ Christine F. Ericson*

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April 21, 2004

CERTIFICATE OF SERVICE

I hereby certify that I caused copies of the foregoing document of the Illinois Commerce Commission to be served this day upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Chicago, Illinois, this 21st day of April, 2004.

*/s/ Christine F. Ericson*

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